IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No.....

GREENE COUNTY NATIONAL FARM LOAN ASSOCIATION, and HAMBLEN COUNTY NATIONAL FARM LOAN ASSOCIATION,

Petitioners,

vs.

THE FEDERAL LAND BANK OF LOUISVILLE, a Corporation, and THOMAS P. COOPER, MARVIN J. BRIGGS, R. S. FOUTS, T. E. HORD, JR., W. E. STOUGH, CARL H. SCHWYN, AND JOE A. VITTITOW,

Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS BELOW

The opinions and findings of fact and conclusions of law of the District Judge appear in the Record at pp. 403 to 221, and is reported in 57 Federal Supplement, 783.

The opinion of the Circuit Court of Appeals appears in the Record at pp. 439 to 448, and is reported in 152 Fed. (2d.) 215.

JURISDICTION

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13th, 1925—28 U.S.C.A. 247(a).

STATEMENT OF THE CASE

A concise statement of the matters involved and the facts which are material to the questions presented are set out in the petition, and in the interest of brevity, will not be repeated.

ERRORS RELIED UPON

It is respectively urged that the Circuit Court of Appeals erred:

(1) In holding that a controversy between the stockholders and a corporation under the supervision and control of an agency of the United States Government does not lie within the field of private corporation law and is not subject to the same strict principles which are applicable to a trust relationship.

(2) In holding that the Federal Land Bank of Louisville, and its directors, have, under the provisions of the Federal Farm Loan Act, power to distribute corporate assets, amounting to three million dollars to one-third of its stockholders to the exclusion of the other two-thirds, as an expedient, and for an intangible consideration.

ARGUMENT

Summary of Argument

Point 1. A Corporation under the supervision and control of an agency of the United States Government has

the same powers, duties and liabilities in its relationship to its stockholders as a private corporation, except in so far as its said powers, duties and liabilities may be changed by an express provision of the Statute under which it is created.

Point II. The Federal Land Bank of Louisville, and its directors do not have either expressed or implied power to distribute corporate assets amounting to three million dollars to one-third of its stockholders to the exclusion of the other two-thirds, except for an adequate and tangible consideration.

POINT I

A CORPORATION UNDER THE SUPERVISION AND CONTROL OF AN AGENCY OF THE UNITED STATES GOVERNMENT HAS THE SAME POWERS, DUTIES AND LIABILITIES IN ITS RELATIONSHIP TO ITS STOCKHOLDERS AS A PRIVATE CORPORATION, EXCEPT IN SO FAR AS ITS SAID POWERS, DUTIES AND LIABILITIES MAY BE CHANGED BY AN EXPRESS PROVISION OF THE STATUTE UNDER WHICH IT IS CREATED.

The Circuit Court of Appeals, in its opinion, **Record pp. 444 and 445,** held that the controversy between the parties does not lie in the field of private corporate law. This holding is based upon the fact that the respondent Bank is under the supervision and control of an agency of the United States Government, and is, in effect, a public or quasi public corporation. The controversy, in its present aspect, is one which involves the relationship existing be-

tween the stockholders and the corporation, and whether or not that relationship is one of a fiduciary nature which requires the same strict application of the principles of law relating to trusts, as have been applied to the same relationship between the stockholders and the corporation in private corporations. We respectfully submit that this question has never been passed upon by this Court; that it is a question of far reaching importance, not only to the parties in this suit, and other corporations organized and existing under the Farm Loan Act, but to many other corporations of a similar nature, which have been and may hereafter be created. A decision of this issue can, and, in all probability will, seriously affect the future economic development of this country.

In so far as the principles here are concerned, it would be difficult to distinguish between the Federal Farm Loan Act, and the National Banking Act, in so far as the trust relationship is concerned, and the supervisory powers and public purposes which might affect a construction of the respective acts.

The powers of the Comptroller of the Currency in the National Banking Act set up, are comparable to the powers and supervisory control of the Farm Credit Administration. The Federal Land Banks, and their powers, are comparable to the powers and functions performed by the Federal Reserve Banks under the National Banking Act, and the National Banks furnish the actual contact with the public, and in the main, carry out the broad general purposes of the Act—that is, to furnish a banking service and its facilities to the people of our country. The only distinguishing feature is the care and caution exercised by the Congress in making into law the Federal Farm

Loan Act, wherein it is provided that in the case of Federal Land Banks, "the stock owned by the Government of the United States in Federal Land Banks, shall receive no dividends but all other stock shall share in dividend distributions without preference." **12 U.S.C.A. 694.**

Obviously this was inserted for the sole purpose of creating confidence in the minds of those who were to become investors, and own at least a part of the stock of these corporations. The success of any large business must depend upon the confidence which it is able to attain and maintain in the investing public, in order that it may acquire the capital with which to operate.

For some time, the legislative branch of our Government has recognized the responsibility of our Government to assist in maintaining proper relationships in the field of industry; that Government supervision and control of many key industries is desirable in order to protect labor from unfair practices of employers, to protect employers in their contracts with labor, and to protect the public from both. This tendency, and the demand for it, are becoming more and more in evidence. While it is not within the province of the judiciary to declare or determine legislative policy, it has always been the tendency of our Courts to encourage progress, and to interfere with legislative policy only when in direct conflict with the express provisions of our Constitution.

We think it is to be conceded that purchase by the Government of the assets of key industries, which have been, and may hereafter be placed under the control and supervision of a governmental agency, is impossible from the ordinary sources of Government revenues. They have, for the most part, been financed in the past by private

investors, and this is, of necessity, the only course open for the future.

The history of the development of private corporations reveals that their progress was slow and tedious until the trust relationship was firmly established and approved by the Courts, with no fine distinctions or exception which could be, under any pretext, used to bring about a preference as between investors, whether directly or indirectly. The rules of expediency were definitely replaced by fixed principles which have remained intact and unvaried. Upon these principles, the confidence of the investing public has been built and firmly established. If this confidence is to be further maintained in corporations under the supervision and control of an agency of the United States Government, the rights of the stockholders must be kept inviolate.

The District Court, in its opinion, **Record pp. 403, to 417,** and the Circuit Court of Appeals in its opinion, **Record pp. 439 to 448,** completely ignored the trust relationship, and the latter Court, in its opinion, **Record p. 448,** correctly referred to the plan which is under attack in this suit as "an expedient."

The Federal Farm Loan System is referred to in the opinion of the Circuit Court of Appeals as "an integrated cooperative organization." **Record p. 446.** If investors are to be attracted to such organizations, the word, "cooperative" must be determined to mean a sharing of the benefits of the common enterprise according to the contributions of the participants to the common effort, and **not a sharing according to their needs.**

We do not concede, as stated by the Circuit Court of Appeals in its opinion, that a reorganization of the Farm

Credit Districts is necessary. However, if such were the case, it would not justify the discrimination among the stockholders of the Federal Land Bank which is the result of the plan under attack. It would not justify replacing the strict principles of law applicable to trusts by principles of expediency and making of Government controlled corporations institutions to serve the stockholders according to their needs.

If it should be determined by this Court, that a reorganization is necessary, then that can be accomplished by other and legal methods expressly prescribed and set out in the Federal Farm Loan Act, which will be hereinafter discussed. However, an abandonment of the whole Farm Loan System, and the establishment of a new one, could not possibly affect our whole economic system, or the public interest as much as a legal precedent which would allay the confidence of present and future stockholders in Government controlled corporations. The investing public is an alert, well informed and cautious public. Doubt and suspicion as to the future of investments inevitably result in economic chaos.

POINT II

THE FEDERAL LAND BANK OF LOUISVILLE, AND ITS DIRECTORS DO NOT HAVE EITHER EXPRESSED OR IMPLIED POWER TO DISTRIBUTE CORPORATE ASSETS AMOUNTING TO THREE MILLION DOLLARS TO ONE-THIRD OF ITS STOCKHOLDERS TO THE EXCLUSION OF THE OTHER TWO-THIRDS, EXCEPT FOR AN ADEQUATE AND TANGIBLE CONSIDERATION.

The District Court held that "the Federal Land Bank of Louisville was vested with all of the usual powers of the ordinary business corporation" (Record 420). That should have been conclusive in the consideration of the issues in the Circuit Court of Appeals, because no appeal was taken from this holding by the respondents, and it is supported by a comparatively recent opinion of the Supreme Court of the United States in **Federal Land Bank v. Priddy, 295 U.S. at page 233, 79 Law Ed., 1408,** in which at page 1411 and page 1412 of the opinion, the Court held that Federal Land Banks "thus have many of the characteristics of private business corporations distinguishing them from the Government itself, and its municipal subdivisions, and from corporations wholly Government owned and created to effect an exclusively Governmental purpose."

As to the considerations supporting the plan, we need look no further than the plan itself, which is filed as Exhibit "B" to the answer of respondents, wherein it is stated:

> "The fundamental consideration, however, though intangible from the standpoint of dollar measurement, is the permanently beneficial effects of the consummation of this plan upon the welfare, and particularly upon the financial improvement of the Louisville Bank and the associations serving as credit institution for the farmers of the Fourth District." (Record 48).

The scope of corporate powers, expressed or implied, has never been extended so as to authorize the distribution of corporate funds to its stockholders, except as dividends on a pro rata basis, or for an adequate and tangible consideration.

A corporation has no power except what is given it by its incorporating act, either expressly or as incidental to its existence. Upon this basic principle, the economic structure of our nation was founded.

This basic principle had its beginning in an opinion by Chief Justice Marshall rendered on February 25th, 1804, in the case of **Head & Armory v. The Prudential Life Ins. Co.**, reported in **2 Cranch, 127, 2 Law Ed., 229**, in which the Court said:

> "Without ascribing to this body, which, in its corporate capacity, is the mere creature of the act to which it owes its existence, all the qualities and disabilities annexed by the common law to institutions of this sort, it may correctly be said to be precisely what the incorporating act has made it, to derive all of its powers from that act, and to be capable of exercising its faculties only in the manner in which that act authorizes. To this source of its being, we must recur to ascertain its powers, and to determine whether it can complete a contract by such communications as are in this record."

Head & Armory v. The Prudential Ins. Co., Co., supra.

The chief point of difference between an ordinary person and the corporation is that a person may do whatever is not forbidden by law, whereas the corporation can do only what is authorized by its Charter and the Statute under which it is created.

B. & O. Railroad Co., vs. Harris, 79 U.S. 69, 20 Law Ed., 354.

Whenever privileges are granted to a corporation, and the grant comes under revision in the Courts, such privileges are to be strictly construed against the corporation, and in favor of the public, and nothing passes but what is granted in clear and explicit terms.

Rice vs. Minnesota and Northeastern R.R. Co., 66 U.S. 359, 17 Law Ed., 147.

A corporation is an artificial being, existing only in contemplation of law, and being a mere creature of law it possesses only those properties which the Charter of its creation confers on it, either expressly or as incidental to its existence.

Louisville C. & Charleston R. Co., v. Leston, 43 U.S. 497, 11 Law Ed., 353.

A corporation has only such rights and powers as are expressly granted, or as are necessary to carry into effect the rights and powers so granted.

In Re German Savings & Loan Association, 253 Fed. 722, 165 C.C.A. 316.

A corporation Charter is the measure of its powers, and enumeration of certain powers implies exclusion of all others not fairly incidental.

B. & O. R. Co., v. Smith, 56 Fed. (2d) 799.

The authority of corporations to make gifts in reasonable amounts to charities, Chambers of Commerce, and similar organizations, has been recognized by the Courts.

However, these are exceptions to the general rule, and in no case we have been able to find is there involved such staggering sums as those contemplated in the proposed plan.

Respondents insist that the disbursements do not constitute gifts, but are transactions between debtor and creditor, and that the relationship of corporation and stockholder should be ignored, because of the fact that the creditor and debtor relationship also exists. They further offer as justification that a majority of these stockholders have agreed to the plan. They completely ignore the fact that a trust relationship exists between the corporation and its stockholders, and that the corporation and its directorate must deal with its stockholders as cestuique trust. Both the District Court and the Circuit Court of Appeals ignored the trust relationship.

> "Stockholders representing a majority of the stock may lawfully make a contract with the company, provided, according to some decisions, they are not also acting as officers or agents of the corporation in the transaction; but such a contract will be more closely scrutinized than if made with a third person, and unless it appears that it was made honestly and for an adequate consideration, equity will interpose to prevent such contract from being used oppressively and in violation of the rights of the minority. In other words, transactions between a majority stockholder and the corporation, while not void, 'will be viewed by the courts with jealousy and set aside on slight grounds'."

Fletcher on Corporations, Vol. 13, pp. 95-97.

A corporation is, in effect, a Trustee for its stockholders.

13 American Jurisprudence, p. 464.

"A director is a fiduciary. Twin-Lick Oil Co., v. Marbury, 91 U.S. 587, 588, 23 L. Ed. 329, 330. So is a dominant or controlling stockholder or group of stockholders. Southern P. Co. v. Bogert, 250 U.S. 483, 492, 63 L. Ed. 1099, 1107, 39 S. Ct. 533. Their powers are powers in trust. See Jackson v. Ludeling, 21 Wall. 616, 624, 22 L. Ed. 492, 495. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. Geddes v. Anaconda Copper Min. Co. 254 U.S. 590, 599, 65 L. Ed. 425, 432, 41 S. Ct. 209. The essence of the test is whether or not under all the circumstances the transaction carries earmarks of an arm's length bargain. If it does not, equity will set it aside."

Pepper v. Litton, 308 U.S. at pp. 306, 307, 84 Law Ed., 289.

"We completely agree with the Commission that officers and directors who manage a holding company in process of reoganization under the Public Utility Holding Company Act of 1935 occupy positions of trust. We reject a lax view of fiduciary obligations and insist upon their scrupulous observance."

Securities and Exchange Com. v. Chenery Corp. 318 U.S. 85; 87 Law Ed., 632.

"The fraud or breach of trust of one who occupies a fiduciary relation while in the exercise of a lawful power is as fatal in equity to the resultant act or contract as the absence of the power. The relation of a stockholder to his corporation, to its officers and to his co-stockholders is a relation of trust and confidence. The corporation holds its property in trust for its stockholders who have a joint interest in it. The officers of the corporation, if not technical trustees for the stockholders, are such in so real a sense that any use by them of the property of the corporation for their own profit to the detriment of any of the stockholders is a breach of their trust and their duty, which is actionable in equity. The stockholders of a corporation are jointly interested in the same property and in the same title. Community of interest in a common property or title imposes a community of duty and mutual obligation to do nothing to impair the property or the title. It creates such a fiduciary relation as makes it inequitable for any of those who thus share in the common property to do anything to or with it for their own profit, at the expense of others who have the same rights."

Jones v. Missouri-Edison Electric Co., 75 C.C.A. 631, at page 637 (8th Circuit).

"A corporation holds its stock as a quasi trustee for its stockholders."

Page, Exr., v. United States, 78 U.S. 268, 20 Law Ed., 135, p. 142.

"A corporation holds its property in trust for its stockholders. The stockholders have a joint interest in the same property and in the same title. Community of interest in a common proper-

ty or title imposes a community of duty and a mutual obligation to do nothing to impair either. It creates such a fiducial relation as makes it inequitable for any of those who thus share in the common property to do anything to or with it for their own profit, to the detriment of others who have the same rights."

Wheeler v. Abilene National Bank Bldg., Co., C.C.A. (8th Circuit), 159 Fed. 391, 16 L.R.A. (N.S.) 892, at page 897.

"It seems also to be well settled that for practical purposes a corporation may, in some respects, be treated as a trustee for the benefit of its stockholders, whenever necessary for the protection of their interests. In a sense it holds the corporate property in trust for the stockholders."

Hyams v. Old Dominion Co., L.R.A. 1915D, 1128, at p. 1137 (Maine Supreme Court).

"That a corporation is charged with many of the duties of a trustee toward its stockholders; that it is bound to exercise proper care and diligence in protecting the title of a cestui que trust, or equitable or beneficial owner; and that it is responsible for any injury sustained by its negligence or misconduct, are propositions so well established as not to require any discussion."

Caulkins vs. Gas-Light Company, 85 Tenn., 695.

The trust relationship existing between the respondent Bank and the National Farm Loan Association cannot be ignored in this instance, any more than in any other situation where a party acts in a dual capacity, such as a guardian, administrator, or trustee, who deals with his re-

latives, business associates, or others with whom he has some relationship which might influence his dealings. The Courts have frequently held that contracts between corporations and their stockholders will be upheld only where the consideration is adequate, and the terms of the contract fair to the corporation.

The fact that a large percentage of the stockholders have approved the plan does not affect the rights of the minority, no matter whether that minority be large or small.

In Heim v. Jobes (8th Circuit), 14 Fed. (2d) 29, at page 32 of the opinion, the Court said:

"One who owns the majority of the stock of a corporation and who dominates and controls such corporation may contract with the corporation, and such contract will be upheld where the consideration moving to the corporation is adequate, where the terms of the contract are fair to the corporation, and where the contract will further the best interest of the corporation. But a court of equity will hold such majority stockholder to the observance of the highest rectitude in dealing with the corporation, and where the contract is unfair and unconscionable, where the consideration is inadequate, or where the contract is not for the best interest of the corporation but subserves the selfish purpose of such stockholder, it will set aside such contract at the instance of the corporation or its minority stockholders.

"In Wheeler v. Abilene National Bank Bldg., Co., supra, Judge Sanborn stated the relation and duties of a majority of stockholders to the corporation and to the minority stockholders as follows:

" 'The holder of the majority of the stock of a corporation has the power, by the election of bidable directors and by the vote of his stock, to do everything that the corporation can do. His power to control and direct the action of the corporation places him in its shoes, and constitutes him the actual, if not the technical, trustee for the holders of the minority of the stock. He draws to himself and uses all the powers of the corporation. In effect he holds an irrevocable power of attorney from the minority stockholders to manage and to sell the property of the corporation, for himself and for them. Times, places and notices of meetings of the directors and of meetings of stockholders become of secondary importance, because the presence, the vote, and the protest of holders of the minority of the stock are unavailing against the will of the holder of the majority. They can act and contract regarding the corporate property, they can preserve and protect their interests in it, only through him and through the courts.

" 'This devolution of unlimited power imposes on a single holder of the majority of the stock a correlative duty, the duty of a fiduciary or agent, to the holders of the minority of the stock who can act only through him, the duty to exercise good faith, care and diligence to make the property of the corporation produce the largest possible amount, to protect the interests of the holders of the minority of the stock, and to secure and pay over to them their just proportion of the income and of the proceeds of the corporate property. Any sale of the property of the corporation by him to himself for less than he could obtain for it from another, or any other act in his interest to the detriment of the holders of the minority of the stock, becomes a breach of duty and of trust,

renders the sale or act voidable at the election of the minority stockholders, and invokes plenary relief from a court of chancery.'

"In Heffern Co-op. Consol. Gold M. & M. Co. v. Gauthier, supra, the court said:

"'There is a prevailing idea with a great many men that majority shareholders of a corporation can conduct the business affairs of the corporation as they see fit. That is not so. While in a narrow and restricted sense it cannot be said that the holder of the majority of the stock of the corporation occupies a relation of trust, yet it can be said in a larger and broader sense that he occupies a fiduciary relation to the holders of the minority stock and the corporation, who can only act through him. In the broader sense the holder of the majority of the stock owes to the other stockholders and the corporation the duty to exercise good faith, care, and diligence to conserve the property of the corporation and to protect the interests of the minority stockholders, and any act of his, in dealing with the property of the corporation, in violation of this duty, for his own selfish interests and gain, will not and cannot be recognized. Majority shareholders can no more, for their own benefit and advantage, appropriate the property of the corporation, than the minority shareholders, and, where the act is in itself a violation of the duty that arises from their fiduciary relation, the corporation can rescind that act'."

Heims v. Jobes, 14 Fed. (2d) 29, 32, 33.

It may be insisted by the respondents that the foregoing authority has been applied, for the most part, where the majority of the stock was in the hands of one person.

We respectfully submit that whether the majority of stock is owned by one or several persons, the relationship and relative duties of the corporation to its minority stockholders are the same.

A corporation, whether its stock be owned by a few or many, has no right to take any action which would result in a discrimination against any part, or all of its stockholders, and any attempt to do so gives rise to a cause of action in favor of those who may be injured thereby.

> "The rule is well settled that, in the declaring and paying of dividends, directors of a corporation have no legal right to discriminate between stockholders of the same class, but all are entitled to participate equally in the distribution of the net profits, unless otherwise provided by the terms of their contract with the corporation. Discrimination in the payment of dividends as between stockholders of the same class is not within the discretion of the officers of the corporation. And, since a person holding as owner the stock of a corporation becomes thereby entitled to a proportionate share in the profits of the company, a duty is imposed by law on the corporate body of a company to distribute all dividends which from time to time may be declared ratably on all the capital stock; and from this duty springs an implied promise upon the part of the corporation to pay a particular stockholder the same rate of dividends which it has declared to the other stockholders, which duty, it has been held, may be enforced in an action of assumpsit.
>
> **55 A.L.R. 65, 66.**

"Majority stockholders have no right to distribute or divide corporate assets to the exclusion of minority stockholders."

13 Fletcher on Corporations, Section 5785 Southern Pacific Co. v. Bogert, 250 U.S. 483; Jones v. Foster, 70 Fed. (2d) 200, Certiorari denied in 293 U.S. 558; 79 Law Ed., 659.

The Circuit Court of Appeals, in its opinion, gave great weight to the fact that there was no fraudulent conduct on the part of the directors. **(Opinion, Court of Appeals, Record 444).** Neither fraudulent conduct, nor willful mismanagement are necessary to give cause to a right of action, where the rights of the stockholders are involved, and the Court so held in Southern Pacific Co., vs. Bogert, supra, at page 492 of the opinion.

"In seeking to prevent the carrying out of the contract, the suit was directed not only against the Power Company but against the Authority and its directors upon the ground that the latter, under color of the statute, were acting beyond the powers which the Congress could validly confer. In such a case it is not necessary for stockholders—when their corporation refuses to take suitable measures for its protection—to show that the managing board of trustees have acted with fraudulent intent or under legal duress. To entitle the complainants to equitable relief, in the absence of an adequate legal remedy, it is enough for them to show the breach of trust or duty involved in the injurious and illegal action."

Ashwander vs. Tennessee Valley Authority, 297 U.S. 319; 80 Law Ed., 696.

We have here not only the relationship of corporation and stockholder, which is one of a fiduciary nature,

but we have what is, in effect, interlocking directorates and managements. While the identity of the board of directors of the Land Bank and the Farm Loan Association are different, they are both under the general supervision of the Farm Credit Administration, which exercises an equal, if not greater, control over both than the interlocking directorates of different corporations.

The Federal Farm Loan Act, under which the Land Bank and the Farm Loan Association are chartered, provides:

> "Its administration shall be under the direction and control of the Farm Credit Administration."
>
> **12 U.S.C.A. Section 641.**

The extent to which this supervision has been exercised is evidenced by the fact that the plan under attack was recommended by the Farm Credit Administration, and approved by it prior to the time the plan was approved by the Bank.

The Courts have gone far in protecting the rights of stockholders under similar situations. As to the debtor creditor relationship, the presumption is in favor of the acts of the directorate, but as to corporations dealing with its stockholders, and particularly where there are interlocking interests, the presumption is against the fairness of the transaction, and the burden of proof is upon the corporation to show that the transaction is absolutely fair and free from fraud.

> "The relation of directors to corporation is of such a fiduciary nature that transactions between boards having common members are regarded as

jealously by the law as are personal dealings between a director and a corporation, especially where a common director is dominating in influence or in character; and, where the fairness of such transactions is challenged, the burden is on those who would maintain them to show their entire fairness and full adequacy of consideration for any sale involved therein. Geddes v. Anaconda Copper Mining Co., 41 S. Ct., 209 254 U.S. 590, 65 L. Ed., 425, reversing 1917, 245 F. 225, 157 C.C.A. 417, which affirmed, D.C. 1915, 222 F. 129."

"The relation of directors to corporations is of such fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, and, where fairness of such transactions is challenged, burden is on those who would maintain them to show their entire fairness, especially where a common director is dominating in influence or in character. First Trust & Savings Bank v. Iowa-Wisconsin Bridge Co., 98 F. 2d 416, affirming, D. C. Bechtel Trust Co. v. Iowa-Wisconsin Bridge Co., 19 F. Supp. 127, and certiorari denied Phoenix Finance Corporation v. Iowa-Wisconsin Bridge Co., 59 S. Ct. 243, 305 U.S. 650, 83 L. Ed. 420, rehearing denied 59 S. Ct. 356, 305 U.S. 676, 83 L. Ed. 437."

"Transactions between corporation boards having common members are jealously regarded, and where fairness of such transactions of such boards is challenged, burden is on those who maintain them to show their entire fairness, Raymond-Eldredge Co. v. Security Realty Inc., Co., 91 Fed. 2d. 168."

"Where agreements are entered into between common directors of a corporation and banks of

which such directors are officers or representatives, the burden of showing the agreements to be fair and absolutely free from fraud rests on him who seeks to uphold the transaction. Irving Bank-Columbia Trust Co. v. Stoddard, 292 F. 815."

"Contracts between corporations having common directors, while not prohibited, are voidable; and the burden rests on those seeking to sustain them to show clearly that they were entirely fair and free from wrong. Geddes v. Anaconda Copper Mining Co., 245 F. 225, 157 C.C.A. 417, affirming D. C. 1915, 222 F. 129, and reversed 41 S. Ct. 209, 245 U.S. 590, 65 L. Ed., 425."

19 Federal Digest, p. 402.

"Common directors and managers occupy fiduciary relations toward both corporations, and contracts between them will be carefully scrutinized. Wentz v. Scott, 10 F. 2d. 426."

19 Federal Digest, p. 402.

Even where there are no interlocking interests, the Courts have consistently, and without exception, held that the directors and officers of a corporation stand in a strictly fiduciary relation towards its stockholders, and are accountable to them on the principles governing that relationship.

McCourt vs. Singers-Bigger, 145 Fed. 103;
Ashman v. Miller, 101 Fed. (2d) 85;
Dunnett v. Arn, 71 Fed. (2d) 912;
Backus v. Finklestein, 23 Fd. (2d) 357

The principles involved here vitally affect not only the petitioners and other stockholders of the Federal Land

Bank of Louisville, but the whole future of the economic structure of this country.

It is a matter of history, that prior to the opinion of Chief Justice Marshall, in Head & Armory v. The Prudential Life Ins., Co., supra, there were but few corporations, and these were, for the most part, closely held. The public was reluctant to invest its funds in any enterprise where their investments would be subject to the will of the majority. The rights of the stockholders have been consistently protected by the Courts by what is frequently referred to in the decisions as the "maintenance of corporate integrity." Even the slightest departure from the well-established rules which protect the rights of stockholders is exceedingly dangerous, and would, most surely, affect the confidence of the investing public in corporate stocks. Many corporations, and particularly commercial banks, are frequently confronted with the same situation as is involved in the case at bar. For example, in the town where the offices of petitioner is located, there is a commercial bank that has as one of its stockholders a man engaged in the automobile business, who, when new cars are available, discounts notes to the bank amounting to from $100,000 to $200,000 annually, and results in an income to the bank of from six to twelve thousand dollars annually. This represents about one seventh of the bank's total income. If this stockholder should get in financial difficulties, and in excess of his assets be indebted to the bank in the sum of $10,000.00, and other creditors in the sum of $10,000.00, we would have a situation comparable to the case at bar, and, it would, undoubtedly, be to the best interest of the bank to keep this particular stockholder in business. However, we respectfully submit that it would be a fraud on other stockholders to expend the

sum of $20,000.00 of the corporate assets to pay his just debts, even though his continued business would offset the expenditures in from two to four years.

The Circuit Court of Appeals in its opinion referred to the cases cited by the District Judge in support of his conclusions. These cases were lightly considered by the Circuit Court of Appeals, because that Court did not find the present controversy to be in the field of private corporate law. However, they were considered to some extent on the question of corporate powers, and we respectfully refer to them briefly.

Atherton v. Anderson, 86 Fed. (2d) 518, recognizes the right of corporate officers and directors to invest corporate funds to protect the value of its security until an advantageous sale can be made.

National Bank v. Watsontown Bank, 105 U.S. 217, involves a transfer of stock where a third party was misled to its prejudice by the act of a corporate officer.

Green Bay etc., R.R. Co., v. Union Steamboat Co., 107 U.S. 98, recognizes the right of a railroad company to contract with a connecting carrier to pay its losses in consideration of the business it furnishes.

Henderson Tire & Rubber Co., v. Gregory, 16 Fed. (2d) 589, holds that a corporation may enter into a contract of guaranty when reasonably incidental to its authorized business.

Marbury v. Kentucky Union Land Bank Co., 62 Fed., (2d) 335, approves a contract of guaranty for the benefits of the corporation where the stockholder relationship is not involved.

Lyon, Potter & Co., vs. First National Bank, 85 Fed., 120, approves the endorsement of a note where the corporation received part of the proceeds.

General Investment Co., v. Bethlehem Steel Corporation, 248 Fed. 303, approves a guaranty agreement by the Steel Co., guaranteeing the bonds of a subsidiary company in the acquisition of property for the benefit of the Steel Co.

Modoc County Bank v. Ringling, 2 Fed. (wd) 535, approves a guaranty agreement for the benefit of a depositor.

Gotham National Bank v. Sharood, 23 Fed. (2d) 567, holds that a promise of a National Bank which held title to goods as security to hold goods of a specified quality for a purchaser from debtor, was not ultra vires, since the bank was cooperating with debtor in the hope of liquidating its own claim.

Allis-Chalmers Mfg. Co. v. Citizens Bank & Trust Co., Fed., (2d) 316, approved a guaranty of $20,000.00 claim secured by prior lien in order to protect a second lien securing over $100,000.00.

Dunn v. McCoy, 113 Fed. (2d) 587, approves a contribution of $12,500.00 by a national bank to a state bank where similar contributions were made by other banks in the same locality to prevent the state bank from closing.

American Rolling Mill Co., v. Commissioner, 41 Fed. (2d) 314, involves a controversy between a corporation and a tax collecting agency as to whether or not a contribution to civic improvement is deductible as a business expense.

Involving the same principle, is **Glassworks v. Lucas, 37 Fed. (2d) 798,** wherein the corporation had made a contribution of $25,000.00 to the building fund of a hospital that would take care of its employees and enable it to avoid enlarging its dispensary facilities at the factory.

Forbes Lithographing Mfg. Co. v. White, 42 Fed. (2d) 287, involves a controversy between a corporation and a tax collecting agency as to whether or not a contribution to a foundation established to assist employees and dependents is deductible as a business expense.

Heinz v. National Bank of Commerce, 237 Fed. 942, approves the creation of a pension fund to be shared by the officers and employees. This case holds that in determining whether or not a given act is within the expressed corporate powers, the judgment of stockholders and directors has no legal weight or bearing, but that in determining whether a given act is within the implied corporate powers, the judgment of stockholders and directors is entitled to consideration, but is not conclusive.

None of the foregoing authorities involve the corporation-stockholder relationship, and none of the authorities support the proposed plan of the respondents, or any part thereof, unless the Bank is a competitive business enterprise. In that event, Green Bay etc. R.R. Co., v. Union Steamboat Co. supra, may be authority for establishing reserves to absorb future losses of associations.

If this Court should find that the Land Bank is a competitive business enterprise, and that the reserves are justified, petitioners are still entitled to their relief for the other disbursements in the form of cash and cancellation of credits, totalling $2,500,000.00.

The cash payments totalling $1,004,875.00, of which sum $979,144.80 was paid by the Bank immediately prior to the commencement of this action, are to enable the Associations receiving the funds to satisfy the stock of their former borrowers (Answer, Record 63 to 67). These claims are evidenced by stock retirement certificates which provide "therefore, this certificate is issued to evidence the right of the above named person, after all obligations of said Association have been satisfied, to share in its net assets, together with other persons having similar rights on the basis of the number of shares held by each, and not to exceed the par value of said shares." (Exhibit, Record 143).

The respondents attempt to justify this expenditure of funds on two theories:

First, that it promotes the goodwill of the business, and

Second, that it is necessary to place the Associations receiving the funds for the benefit of their former borrowers in solvent condition, so that they can be consolidated with other Associations, under the reorganization plan.

As to their first theory, the Associations can receive no benefit from this fund because it comes to the Associations irrevocably earmarked and must be paid to former borrowers who have liquidated their loans and are not prospects for future loans any more than any one of the several million other American farmers.

If, by stretch of the imagination, it can be assumed that there is a small tangible benefit passing to either the Association or the Federal Land Bank for this expenditure of funds, it is infinitesimal as compared to its cost.

The sum of $1,004,875.00 is paid to 127 Associations, as shown by Exhibit 64, Record 349 to 381.

A few of these disbursements are as follows:

Association	Amount of Land Bank Stock Owned	Amount Received Under the Plan	Record Page
Elk Hart County	$134,000.00	$64,000.00	357
Grant County	55,320.00	27,580.00	357
Boone County, Group 1	39,685.00	28,170.00	361
Western Indiana	34,480.00	21,710.00	363
Graves County	13,675.00	11,000.00	367
Columbia	5,125.00	6,875.00	369
Wayne County	7,085.00	5,918.00	373
Perry County	3,415.00	3,910.00	377
Maury County	24,005.00	16,150.00	377
Rhea County	6,565.00	14,542.00	379

These are only a few of the 127 stockholders who received for the benefit of their former stockholders the equivalent of a cash dividend on their stock in the corporation, amounting to from 50% to 225%. At the same time the petitioners and the 303 other Associations in Classes 1 and 2 in the Fourth Farm Credit District received nothing.

As to the respondents' second theory that these payments are necessary to place the receiving Associations in solvent condition so that they can participate in the consolidation plan, this is answered by the terms of the participating, or stock retirement certificates. (Exhibit, Record 143). The status of the former borrower is not changed. He is still a stockholder and the payment of his stock has only been delayed until such time as the Association may have sufficient assets to pay him, along with the others, in the same situation. He is, in no sense of

the word, a creditor of the Association, since a stockholder is not, by virtue of the fact that he owns stock, ever a creditor of the corporation.

Thompson on Corporations, Section 4474.

In the case of **In Re Phoenix Hotel Co. of Lexington, 83 Fed. (2d) 724, at 726 (Sixth Circuit), the Court said:**

> "It is a fundamental rule of corporation law that one cannot be at the same time both a stockholder and a creditor of a corporation in respect to the same funds hazarded in the corporate enterprise."

In addition to the cash payments as aforesaid, the Land Bank proposes to cancel indebtedness against 152 of its stockholders, amounting to $1,840,000.00 (Exhibit, Record 349 to 381). A few of the Associations who will receive benefits in the form of cancellation of debts are as follows:

Association	Amount of Land Bank Stock Owned	Amount due Bank and to Be Cancelled	Record Page
Morrow County	$ 8,605.00	$18,871.00	351
Brown County	5,185.00	10,451.00	355
Elk Hart County	134,120.00	253,762.00	357
First Whitley, Group 1	60,305.00	96,975.00	357
Jay County	18,625.00	52,692.00	357
Eastern Indiana	12,225.00	15,481.00	359
Scotsburgh	13.955.00	62,355.00	359
Neils Creek	1,495.00	11,519.00	359
White County	6,020.00	68,012.00	361
White River	25,445.00	71,008.00	365
Center Township	790.00	7,281.00	365
Greene River	24,915.00	45,304.00	367
Weakley County	15,145.00	29,534.00	375

These 13 Associations received from 1½ to 9½ times the amount of the stock owned by them in the form of forgiven indebtedness, while the other 280 Associations in the District received nothing.

The Center Township Association with $790.00 par value of Land Bank Stock has furnished the Bank loans totalling 20 times that amount, or in the amount of $14,800.00.

There is nothing in the record to indicate that the goodwill of this Association is worth the sum of $885.00 to be paid in cash and the cancellation of an indebtedness amounting to $7,281.00.

The goodwill of any business enterprise that has been operated on a basis as unsound as the Associations who have permitted themselves to get in such difficulties, can have no value.

In considering the value of the goodwill of the Associations, the Court below overlooked the fact that under the plan these Associations exist only until solvency is accomplished, and then became nonexistent, losing their corporate identity, their officers and directors, and even losing their assets which become a part of the consolidated Associations (Record 281 to 296). The goodwill of a corporation can have no value today, if it is to surrender its Charter and become nonexistent tomorrow.

In considering the question of goodwill, the Court below further overlooked the fact that neither the Land Bank nor the Associations are competitive business institutions. Goodwill has been defined as "something in business which gives reasonable expectancy of preference in 'a race of competition'."

18 Words & Phrases, Permanent Edition, 552.

It is not the purpose of the Federal Farm Loan Act to encourage borrowing, or to engage in a race of competition with private lending agencies, but rather it is to afford a remedy for farmers in financial distress. It is apparent, from an examination of the Federal Farm Loan Act, that it was the intention of the Congress to afford credit to farmers at reasonable rates, but not on a competitive basis, and we seriously doubt that opposing counsel would insist that the Land Bank is engaged in a competitive business.

It is insisted by respondents that this expenditure of funds is necessary to extricate the Land Bank from a perilous situation, and to create confidence in the Land Bank business.

It is, undoubtedly, true that in recent years the amount and number of loans of the Federal Land Bank, and for that matter, of all other lending institutions, have been substantially reduced. This is the natural result of economic trends, and there is nothing in the record to indicate to the contrary. As of December 31st, 1943, respondent, the Federal Land Bank of Louisville, had an earned surplus of $12,616,141.94, a legal reserve of $11,338,700.00, and reserves against specific assets amounting to approximately $4,000,000.00. This does not indicate that it is in any grave peril. It has lost, and will continue to lose small amounts from time to time. However, the proposed plan is not a salvage proposal to recover on losses heretofore incurred, and which may be incurred in the future, but it is an outright gift, based solely upon the needs of recipients. The disbursements are not based on the stock held by the receiving Associations **(Record 111)**, and they are not to be repaid **(Record 111)**.

Every borrower who has dealt with Farm Loan Associations since their beginning has done so with full knowledge that Congress provided for the withholding of stock proceeds in the event of insolvency of the Associations, and provided for the liquidation of insolvent Associations. It also held out to borrowers as stockholders of the Associations, the promise that their Associations would be rewarded for diligent management, not only by the repayment of stock proceeds, but by the payment of dividends from the earnings, of the corporation. The Federal Farm Loan Act provides:

> "After deducting the 50 per centum or the 10 per centum, etc., * * * directed to be deducted for credit to reserve account by section 901 of this title, any Federal Land Bank may declare a dividend or dividends to shareholders of the whole or any part of the balance of its net earnings, * * *."
>
> **12 U.S.C.A. Section 902a.**

> "After deducting the 10 per centum or the 5 per centum directed to be credited to reserve account, said association may at its discretion declare a dividend to shareholders of the whole or any part of the balance of said net earnings, provided, etc., * * *."
>
> **12 U.S.C.A. Section 913.**

In spite of the splendid financial condition and a large surplus, respondent, The Federal Land Bank of Louisville, has not paid a dividend on its stock since 1930 **(Exhibit Record 392).**

To not only repudiate the promise held out to borrowers by the Statute, but to completely reserve the matter

by rewarding the careless at the expense of the more diligent would be far more apt to destroy confidence than the liquidation of a few Associations which, through either their own mismanagement or the misdirection of the Farm Loan Administration, have become hopelessly insolvent.

Congress anticipated such a condition as exists in many of the Associations at the present time and provided the remedy which will be discussed later. If it had been the intention of Congress that either the Farm Credit Administration, or the Federal Land Bank should deal with insolvent Associations as they saw fit, it would have said so. There is nothing in the Act from which such authority can be implied.

In addition to the cash payments and the cancellation of the indebtedness heretofore discussed, the Bank proposed to set up reserves for anticipated future losses of the Farm Loan Associations—all of which are its stockholders, amounting to $620,333.00 **(Exhibit 345).** Any Association showing a need for such a reserve may share in these benefits. However, it is not on a "stock ownership basis," and is, in effect, the forgiveness of an anticipated future debt. The agreements to set up these reserves are definite commitments **(Exhibit, Record 56; Exhibit 59; Exhibit, Record 63; Exhibit, Record 67).**

These funds are earmarked for this particular purpose. Whether any of them will ever be returned to the assets of the defendant Bank is dependent upon the amount of the losses actually sustained by the Associations for which the reserves are set up. General economic conditions and other factors will determine the extent of the use of this fund. There is no present consideration, either tangible

or intangible, for this feature of the plan, and it is not even insisted by defendant that it could, in any way, effect a consolidation of Associations and the reorganization of the Fourth Farm Credit District.

The Circuit Court of Appeals held that the stock redemption certificates are clearly a debt which must be considered in determining the solvency of the Associations, and it is, apparently, upon this holding that its approval of the cash payments is predicated.

The Court should have held that the payment by the corporation of the sum of $1,004,875.00 to one-third of its stockholders to be used by them in retiring such certificates was authorized and invalid, and was not necessary to reorganize and consolidate Associations. When a stockholder in the Association pays his loan to the Federal Land Bank and his stock proceeds are withheld because of the insolvency of his Association, he is issued the certificate hereinbefore referred to **(Exhibit, Record 143)**, which gives him the right to share in the net assets of the Association. This does not change his status from that of a stockholder to a creditor, but even if the instrument could be construed as effecting such a change, it is not an obligation which affects the solvency of the Association which issues it. Whether the Association issuing the certificate surrenders its Charter, is liquidated or consolidated with other Associations, it loses its identity, and the right of the certificate holder becomes fixed and is to be determined by the net assets available at that time for payment under the terms of the contract. That is not an advancement for future salvage, because it is not contemplated that there will be any return to the Association or Land Bank of any part of the original fund **(Record 111)**, much less any addition thereto. It cannot involve the element of good

will, for such payments are to Associations, that become non existent under the consolidation plan, and the funds are immediately paid to borrowers who have paid their loans in full.

In attempting to justify their position, respondents attempt to distinguish between, "stock proceeds withheld and unapplied," and "stock proceeds applied" **(Exhibit, Record 345).** These can be nothing more than bookkeeping terms. The stock has been cancelled and the proceeds are a part of the corporate assets, regardless of what they may be called, or in which pocket they may be kept. However, if we make the distinction which the respondents would like for the Court to make, there is still $265,000.00 which has been "applied" **(Exhibit, Record 345).** And the expenditure of this sum cannot be justified, even if the theory of the respondents is adopted by this Court.

The proposed consolidation plan could be effected by a strict compliance with the Federal Farm Loan Act without the expenditure of funds and the cancellation of debts of its stockholders, and without losing any of the benefits claimed for the plan.

The District Court held that the applicable statutes are permissive rather than mandatory, and do not constitute the exclusive method of dealing with the situation. **(Opinion, District Court, Record, 415, 416).** This holding was affirmed by the Circuit Court of Appeals, Record 447, 448.

The Court should have held that the expression of one thing, or mode of action in the Statutes under which the Land Bank operates, excludes any other. The applicable Statutes are as follows:

"Upon receiving satisfactory evidence that any national farm loan association has failed to meet its outstanding obligations of any description the Farm Credit Administration may forthwith declare such association insolvent and appoint a receiver, etc., * * * ."

12 U.S.C.A. Section 961.

"Upon receiving satisfactory evidence that any national farm loan association has failed to meet its outstanding obligations of any description, and that it will be to the best interests of its creditors and stockholders for the association to continue in business, the Farm Credit Association may, in its discretion in lieu of appointing a receiver as provided herein, appoint a conservator for such association and require of him such bond and security as the Administration may deem proper. * * * ."

Title 12 U.S.C.A. Section 967.

The foregoing Statutes contain the only provision for the handling of insolvent associations, and no other authority is given in the powers granted by Congress to Federal Land Banks which are enumerated in Title 12, U.S.C.A., Section 781.

Section 967, supra, providing that "in lieu of appointing a receiver," a conservator may be appointed, clearly indicates an intention on the part of the Congress that this shall be the only alternative remedy, or mode of procedure. This construction is strengthened by the further provisions of the Federal Farm Loan Act which makes provisions for the continuance of the Farm Loan service in the territory of the Association, when, by reason of insolvency, it is

no longer able to take obligations and make loans. It provides as follows:

> "* * * The boundaries of the territory designated in the Charter of any national farm loan association may be readjusted from time to time to meet the farm loan needs of the locality as determined by the Farm Credit Administration."
>
> **Title, U.S.C.A. Section 719.**

> "Whenever it shall appear that the capital stock of a national farm loan association is impaired, the Farm Credit Administration may authorize the Federal Land Bank of the District in which such association is located to make loans to applicants through such association, subject to the requirements and conditions specified for direct loans in paragraphs 12 to 16, etc., * * * *"
>
> **Title 12, U.S.C.A. Section 724.**

Under the foregoing Statutes, the Federal Land Bank can extend the territory of solvent farm loan associations so as to include that territory occupied by insolvent associations, and it has authority to continue loan services in the meantime.

In construing these Statutes, and in giving them the meaning which Congress intended, the general rules approved by this Court are applicable.

The primary rule in construing statutes is to ascertain and give effect to the legislative intention.

> **Fidelity & Deposit Co. v. Arenz, 290 U.S. 66, 78 Law Ed., 176.**

Courts must give effect to the intent of Congress manifested in the Statute.

U.S. v. Scharton, 285 U.S. 518, 76 Law Ed., 917; Croson v. District of Columbia, 2 Fed. (2d.) 924.

Statutes will not be construed so as to lead to unjust oppressive or absurd consequences, or to self-contradiction.

Northern Pacific Railroad Co., v. U.S. 213 Fed. 162, affirmed in 242, U.S. 190; 61 Law Ed., 240.

A construction of the statute which would sanction an evasion of the whole policy of the law ought, in no case, to be adopted unless the natural meaning of the words of the Act require it.

The American Fur Co., v. U.S. 2 Peters (358); 7 Law Ed., 450;

Piper v. Willcuts, 64 Fed. (2d) 813.

Courts should, if possible, construe statutes so as to produce a harmonious and consistent result.

In Re: Bank of New York, 278 U.S. 101, 73 Law Ed., 202.

The foregoing rules of construction have been applied in **Greene v. Wheeler (Seventh Circuit), 29 Fed. (2d), 468,** wherein the Court, in referring to the National Farm Loan Act, said:

> "The act shows that it was anticipated that there would be cases of insolvency and failure; that in such cases the association or bank would

> cease to function normally; that, if creditors were to be protected and debtors compelled to meet their obligations, some agency, other than the bank or the association, would have to intervene."
>
> **Greene v. Wheeler, supra.**

It will be insisted by the respondents that a strict application of the Statute would prevent consolidation. In this connection, we respectfully call the Court's attention to the map which appears in the record as an Exhibit (Record 73), and particularly that part of the map showing Jefferson County, Kentucky. It is proposed that the associations of Jefferson, Bullitt, Spencer and Nelson Counties be consolidated into one association, and that each of these associations would cease to exist as a corporate entity. To accomplish this, and in strict compliance with the Federal Farm Loan Act, it is immaterial whether either or all of these associations are solvent. If one or more is solvent, under Section 719, supra, its territorial limits can be extended to include the territories served by other associations. If all are insolvent, one, or all of them may be liquidated and a new association formed to serve this territory.

The District Court should have held that the doctrine of expressio unius est exclusio alterius applied.

> "The expression of one thing or mode of action in a statute excludes any other, though not prohibited by negative words."
>
> **Fidelity & Casualty Co. of New York v. Allen, 84 Fed. (2d) 53; (Seventh Circuit).**

> "The statute limiting a thing to be done in particular mode includes the negative of any other mode."
>
> **Martin v. Commissioner of Internal Revenue, 61 Fed. (2d) 942 (Second Circuit).**

When the Congress provided for a receivership and liquidation of insolvent Associations, Section 961, supra, and provided "in lieu thereof" for continued operation under a conservator, Section 967, supra, it closed the doors to any other plan of dealing with the situation. The only matter in which the Farm Credit Administration, or the Land Bank were given any discretion was in determining when the condition of insolvency had reached the extent that one or the other of those remedies was required.

It certainly was not the intention of the Congress to give either the board of directors of the respondent Bank, or the Farm Credit Administration discretion in the use of corporate assets which could, or would, involve expenditures of corporate assets to any stockholder or group of stockholders to the exclusion of others with equal rights.

Since there is no authority, under the Act, for making such disbursements, they are, in effect, dividends. The relationship existing between a corporation and its stockholders is one of trust, as hereinbefore discussed, and the dealings between them must be at arm's length.

No matter what the dealings may be called by the corporation and directorate, when the rights of the stockholders are involved, the transactions between them must be construed according to their legal effect.

Wolter v. Johnston, 34 Fed. (2d.) 597.

Since corporations have no right to distribute their assets to stockholders, except in the payment of dividends, a division of profits to stockholders amounts to a construc-

tive dividend, whether it is intended by the directors or stockholders to constitute a dividend or not.

Fletcher on Corporations, Section 5318;
Hadley v. Internal Revenue Commissioner, 36 Fed. (2d.) 543;

Savings Bank v. Brewer, 17 Fed. (2d) 79.

Annotations in L.R.A. 1918 B. pp. 1051 and 1052, from which we quote, as follows:

> "Where all the stockholders of a solvent corporation at their annual meeting agreed to 'charge off' certain real estate of the company with the understanding that it was to be conveyed to the stockholders, and it was so conveyed, this constituted a dividend. Grants Pass Hardware Co. v. Calvert (1914), 71 Or. 103, 142 Pac. 569."

Ann., L.R.A. 1918 B, p. 1051.

> "In Smith v. Moore (1912), 118 C.C.A. 127, 199 Fed. 689, money taken by a controlling stockholder from a corporation through many years were considered as dividends, and a purchase of his ward's stock by him as guardian having been set aside as illegal, he was compelled to account to the owner of such stock for its proper proportion of such moneys as dividends. The court said: 'While it is true that in general a corporation is a distinct entity from its stockholders, nevertheless, where an individual owns practically all of its stock and controls all of the operations of the corporation, they are, in proper case, regarded by the courts as one and the same. . . So may a court of equity, which always looks through the form to the substance of

things, avoid the necessity of driving a wronged party to a circuity of actions, and treat as dividends all amounts received in consequence of a division of the profits of the corporate business, as the court below directed the master to do, and as he did do, as shown by his report, confirmed by the trial court.' The court below said inter alia: 'A division of the profit without the formality of declaring a dividend is equivalent to declaring a dividend, and such division of the profits is a dividend, even though not called such and not considered such by the directors and stockholders'."

Ann., L.R.A. 1918 B, p. 1051.

"While the formal way of transferring profits to a corporation's only stockholder is by the declaration of a dividend, if the corporation turns over its profits to the stockholder without this formality the transaction is good, and may not be attacked where the act does not impair the rights of third parties. Central of Georgia R. Co., v. Central Trust Co. (1910), 135 Ga. 472, 69 S.E. 708."

Ann., L.R.A. 1918 B, p. 1052.

"In Hartley v. Pioneer Iron Works (1905), 181 N.Y. 73, 73 N.E. 576, it was said that a 'division of profits without the formality of declaring a dividend is the equivalent of declaring a dividend."

Ann., L.R.A. 1918 B, p. 1052.

If this Court should be of the opinion that the foregoing authorities do not establish conclusively the legal right to so hold, there is no doubt but that this Court has equitable jurisdiction to hold that said payments constitute

a dividend. There is no legal right to distribute assets to stockholders except (a) as compensation for services; (b) compensation for property, or (c) as dividends. There is not even the slightest intimation that the disbursements are compensation for either services or property. One of the maxims that is a component part of equity jurisprudence would require the Court to hold that the payments are, in effect, dividends, for that is the only legal way it could have been done. The maxim is that "equity regards that as done which should have been done."

The respondent Bank has paid approximately $1,000,000.00 in cash to 151 of its stockholders who own 2¼ million dollars of its capital stock. On this basis, a similar dividend to the remaining 281 stockholders, owning six million dollars of its capital stock, amounts to 2½ million dollars.

It is not the intention or desire of the petitioners to, in any way, impair the capital structure of the Land Bank. As a matter of fact, it is the primary purpose of this suit to protect and maintain a strong corporate structure, and this can be done by making a proper distribution to all stockholders. After the payment of the dividends, as above suggested, and which both the directors and the Farm Credit Administration have, in effect, approved, the capital structure would be as follows:

Capital $7,900,000.00; earned surplus remaining $9,600,000.00; legal reserve $11,300,000.00; making a total of $28,800,000.00. These figures do not include specific reserves against assets amounting to more than four million dollars (Exhibit, Record 242). And more than one million dollars due from Associations carried as assets and not reflected in the published statement of condition (Record 111).

With $113,600,000.00 in loans outstanding, the Bank would have to suffer a loss in excess of 25% to affect its solvency. According to past experience, including the worst economic depression this country has ever known, the average loss on loans in this District is less than 2%, and that amount, even during most of the depression years, was far exceeded by its earnings. Such a dividend would place all Associations in Class 2 in good condition, and would save approximately one-fourth of the Associations in Class 3 (Record 351, 381).

The record (pp. 351-381) shows the ones remaining are so hopelessly insolvent that they should be liquidated and the Charters of adjoining Associations amended so as to include their territories, as authorized by Section 719 of the Act. A substantial part of the dividends to Class 1 Associations are, by Statute, required to be placed to legal reserve so that they would be in stronger position and better able to absorb future losses. So that only a small amount, if any, of the future losses would ultimately be borne by the defendant Bank. Consolidation could then be effected and every savings anticipated under the proposed plan could be made without, in any way, conflicting with the Statute, and that is such procedure as the Statute contemplated. It is true this would leave some Associations to be liquidated, but that is a situation to be expected in any field of endeavor, and was contemplated by the Congress—otherwise the provisions for receivership and liquidation would not have been made in the Act. These are normal casualties of a business cycle. They are not the first, and neither will they be the last.

The petitioners and 280 other Associations and their stockholders have been diligent in the administration of

their affairs, and in the making of loans. Certainly they should not be penalized for their diligence. The payments in cash already made to the other Associations will constitute an unjust discrimination against petitioners and other stockholders in like situation, unless they receive similar amounts based upon the stock held by them.

It is insisted by the respondents that the petitioners and others in like situation have received gifts from the defendant corporation in the past under servicing resolutions and agreements, and are, therefore, estopped to challenge the action of respondents in this case. This contention is not supported by the record. It is specifically stated in the Stipulation of Facts (Record 100-101) that payments were made to Associations based upon the current number of loans outstanding, as compensation for services rendered by them, and that additional allowances were made based upon additional services by the Association.

Exhibit, Record 185, 186, sets out in detail the services performed by the Association under the agreement, and there is nothing in the record to indicate that the payments were excessive in view of the services rendered.

While the record does not sustain this contention, if it were true, the doctrine of estoppel would not be applicable.

The stockholders of the Federal Land Bank are, for the most part, farm loan associations, existing under the Statutes of the United States, and subject to the same rules relative to limitation of powers as the Federal Land Bank.

There is nothing in the Act creating these associations which gives them authority to agree to such a disposition

of the funds in which they have an interest, as that proposed by the respondents in this suit. And, any attempt, on their part, to enter into such an agreement would be ultra vires.

> "A contract, if ultra vires, that is beyond the express or implied powers of the corporation cannot be made valid by the application of the doctrine of estoppel even though such contract is performed by the other party thereto, and although benefits have been received under it."
>
> **American Jurisprudence, pp. 823, 824.**

> "A contract made by a corporation beyond the scope of its powers, express or implied, on a proper construction of its Charter, cannot be enforced or rendered enforceable by the application of the doctrine of estoppel."
>
> **California Nat'l. Bank v. Kennedy, 167 U.S. 362, p. 371. 42 Law Ed., 198, at p. 201.**

> "A contract outside the scope of corporate powers is not voidable, but wholly void. It cannot be ratified because it could not have been legally made."
>
> **People ex rel. v. State Bank, 101 A.L.R. 514 (Ill.).**

To the same effect, see **Central Transportation Co., v. Pullman Co., 139 U.S. 24; 35 Law Ed., 55.**

> "It is the well settled doctrine of this court that no right arises on an ultra vires contract, even though the contract has been performed; and that this conclusion cannot be circumvented by erecting an estoppel which would prevent challenging the legality of a power exercised."
>
> **Texas & R.P. Co. v. Pottorff, 291 U.S. 245, p. 260;**

In McCormick v. Market Natl. Bank, supra, the Court, at p. 549 of 165 U.S. 41 Law Ed., 821, said:

> "The doctrine of ultra vires, by which a contract made by a corporation beyond the scope of its corporate powers is unlawful and void, and will not support an action rests, as this court has often recognized and affirmed, upon three distinct grounds: the obligation of anyone contracting with a corporation to take notice of the legal limits of its powers; the interest of the stockholders, not to be subject to risks which they have never undertaken; and above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law."
>
> **McCormick v. Market Natl. Bank, supra.**

In **Colley v. Chowchilla Natl. Bank, 52 A.L.R. 569** (Supreme Court of California), there was involved a release of notes due a National Bank in consideration of the assignment by the maker of an interest in real property to another bank. After discussing and approving the general rule, that a consideration for a release moving from the release to a third person at the request of the releasor is an adequate consideration, the Court, at page 573 of the opinion said:

> "But, notwithstanding the above set forth principle, we must here deal with a corporation whose powers are circumscribed by the statutes of the United States. In short, we have as the alleged releasor a national banking association, which has, in practical effect, agreed to give a satisfaction of the debt without special benefit of any kind to itself. The legal consequence of the promise as found by the court is that the corporation has covenanted to make a gift to its capital

> assets for the doing of an act, detrimental to the doer, it is true, but without benefit to itself, and beneficial only to a third party whose connection, if any with appellant does not appear from the record. In other words, may a national bank under its powers as defined by the law be held to such a covenant? Appellant insists that such a contract, if proved, would be ultra vires the power of the corporation, and we think this contention must be sustained."

Colley v. Chowchilla Nat. Bank, supra, p. 573.

Even if the Association had authority to prejudice the rights of their stockholders by acts upon which an estoppel could be based, there are no facts to support this insistence. Petitioners were diligent in asserting their rights. The plan was approved for submission to the Association on July 19th, 1943, and declared effective by resolution of the Executive Committee of the Bank January 1st, 1944 (Record 107).

This suit was instituted on January 5th, 1944.

The importance of the rights of the stockholders in the Bank is evidenced by the fact that the Congress, in passing the Federal Farm Loan Act, saw fit to specifically provide that there should be no discrimination among them. The Act provides:

> "The stock owned by the Government of the United States in Federal Land Banks shall receive no dividends, **but all other stock shall share in dividend distributions without preference."**
>
> (Underscoring ours.)

12 U.S.C.A. Section 694.

This Statute must be wholly ignored if the Bank's plan is followed. The resulting preference cannot be denied, and the fact that a Governmental agency is involved does not create either a distinction or a difference.

In **The Bank of United States vs. The Planters' Bank of Georgia, 9 Wheaton, 907, 908,** the Court said:

> "It is, we think, a sound principle, that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. * * * * * * * * * * * As a member of a corporation, a government never exercises its sovereignty. It acts merely as a corporator, and exercises no other power in the management of the affairs of the corporation, than are expressly given by the incorporating act."
>
> **The Bank of the U.S. v. The Planter's Bank of Georgia, supra.**

CONCLUSION

It is respectfully submitted that the opinion of the Circuit Court of Appeals is erroneous in the particulars hereinbefore set out. In view of the important issues involved not heretofore passed upon by this Court, and other issues which are in conflict with former decisions of this

Court, it is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted,

F. H. PARVIN,
Counsel for Petitioners.

B. B. FRAKER,

SUSONG, PARVIN & FRAKER,

Of Counsel for Petitioners.